## EXECUTIVE SUMMARY

## THE FEDERAL GOVERNMENT SHOULD LIMIT THE POTENTIAL LIABILITY OF REGIONAL TRANSMISSION ORGANIZATIONS

For several years, the Federal Energy Regulatory Commission (FERC) has been in the process of restructuring the United States wholesale electricity market in an effort to improve its efficiency. FERC has concluded that its ability to complete the process of socially beneficial restructuring is critically dependent on the creation of Regional Transmission Organizations (RTOs). Each RTO would exercise complete control over the operation of the many transmission lines that comprise an integrated regional grid. Those lines are owned by numerous investor-owned and governmentally-owned utilities. That balkanized ownership structure creates severe inefficiencies and inequities in the absence of an RTO that exercises plenary control over the operation of the entire integrated grid. Since RTOs are multistate entities that operate exclusively in interstate commerce, they are necessarily subject to exclusive federal regulation.

Prior to the restructuring of the electricity market, transmission of electricity was regulated primarily by each state. For nearly a century, every state has concluded that owners of transmission lines should be protected from potential catastrophic damage awards through inclusion of damage limitation provisions in their state-approved tariffs. Virtually every state regulatory agency has authorized liability limitation provisions, and virtually every state court has upheld such provisions as reasonable and valid. The provisions vary to some extent, but the typical provision insulates an owner of a transmission line from liability for economic losses attributable to service outages or disturbances that were allegedly due to negligence.

Agencies and courts usually give five reasons why owners of transmission lines should be subject to limitations on their liability:

- They produce lower rates;
- They assure fair and reasonable treatment for all customers and avoid the inequity of requiring small customers to subsidize large customers;
- They protect owners of transmission lines from potential catastrophic losses and financial distress, thereby making it easier and less expensive for them to attract the large amounts of capital required to make much-needed investments in expansion of the capacity of transmission grids;
- Large customers are in a better position than owners of transmission lines to estimate their exposure to economic losses attributable to a potential loss of power and to protect their own interests; and,
- Owners of transmission lines are regulated monopolies that cannot pick and choose their customers or vary their rates to reflect differential damage exposures.

FERC routinely approved liability limitation provisions in the tariffs of transmission line owners until it announced its intent to encourage transmission line owners to create RTOs. At that time, FERC stated that it would no longer authorize such provisions, and it has refused to allow any RTO to include a liability limitation provision in its tariff since. FERC has never explained the basis for this surprising change in policy. It has referred only to a judicial decision that it interprets to bar it from approving liability limitation provisions and to its belief that federal liability limitation provisions are unnecessary because pre-existing state-approved liability limitations are adequate to protect RTOs. FERC has misinterpreted the judicial decision on which it relies. Properly understood, all of the relevant judicial precedents support both the existence of FERC authority to approve liability limitation provisions and the need for it to approve such provisions.

It is by no means clear that state-authorized liability limitation provisions apply to RTOs because RTOs are subject to exclusive federal regulatory authority. The absence of federallyauthorized liability limitation provisions will discourage transmission line owners from giving RTOs the power to control the operation of their lines. Moreover, relying only on state-approved liability limitations to protect federally-regulated RTOs makes no sense. In the absence of a uniform federal liability limitation an outage on any integrated regional grid would have the potential to produce multi-billion dollar litigation that would raise a host of difficult and complicated issues like: which state's laws apply; which, if any, state-approved liability limitation provisions apply; whether the plaintiffs can sue the individual line owners as well as the RTO, and how to allocate damages when some defendants are government agencies that are protected by sovereign immunity.  Since RTOs are multistate entities that operate exclusively in interstate commerce and are regulated exclusively by the federal government, they should be subject to uniform federal limitations on their potential tort liability.

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